



ROBERT D. TESTA
/ice President
Government Relations

April 7, 1998

The Honorable John M. McHugh, Chairman
Subcommittee on the Postal Service
Committee on Government Reform and Oversight
2157 Rayburn House Office Building
Washington, D. C. **205 15-6143**

Dear Mr. Chairman:

Attached are the comments of CNF Transportation Inc. in response to your letter requesting our views on the proposed revisions to H. R. 22, the proposed Postal Reform Act of 1997.

We commend you on the thoughtful proposal you have advanced and look forward to being of assistance to you and the members of the subcommittee as you proceed with this issue.

CNF Transportation Inc. is a diversified holding company with businesses in regional and trans-continental trucking, domestic and international air freight, global logistics management, trailer manufacturing and wholesale truck parts. Its subsidiaries include Emery Worldwide, Con-Way Transportation Services, and Menlo Logistics. Emery Worldwide and other subsidiaries of the Company currently hold contracts to provide services to the U. S. Postal Service.

As you requested, I have enclosed with this letter a computer disk with a Word file containing this letter and its attachment.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert D. Testa". The signature is fluid and cursive, with a long horizontal stroke at the end.

Robert D. Testa

Enclosure

Comments Submitted to

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
SUBCOMMITTEE ON POSTAL REFORM

On the proposed revisions to H. R. 22
The Postal Reform Act of 1997

By

CNF Transportation Inc.
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April 7, 1998

COMMENTS ON PROPOSED REVISIONS TO THE POSTAL REFORM ACT OF 1977

General Comments

Distinction Between “Competitive” and “Non-Competitive” Products. The proposed distinction between, and separate treatment of, “competitive” and “non-competitive” products is artificial and will be unworkable in practice. The Postal Service actually faces competition in *all* of its product lines, not just those products classified as “competitive” by the proposed legislation. First Class mail, which accounts for roughly 60% of the Postal Service’s total revenue, is identified as a non-competitive product. But the biggest challenge facing the Postal Service over the next ten years is the predicted decline in First Class mail from competing products and technologies. The majority of First Class mail is related in some way to a monetary transaction (e.g., bank statement, invoice, payment). Electronic communications continue to make substantial inroads in these areas, and have already substantially reduced the Postal Service’s market share in these transactions. The proposed revisions to H.R. 22 seem to be based on the unwarranted assumption that the Postal Service has captured the market for communications that are currently handled by First Class mail. Because the Postal Service faces very real competition among all of its products, establishing artificial designations of “competitive” and “non-competitive” products will not help the Postal Service meet its mission of public service to the American people in the next century.

The proposed method of separating the Postal Service into two entities, depending upon what type of service is being offered, cannot work successfully. The proposed “competitive” products — including Express Mail, Priority Mail, and Parcel Post — cannot be realistically separated from “non-competitive” products. These services are equally available at USPS’s 40,000 retail outlets, share rides in the same postal delivery vehicles, and will be delivered by the same USPS letter carriers. It is pointless to create a separate corporate entity to be in charge of these products. Creating such a separate entity that must comply with vague funding and operating restrictions will hamper the Postal Service’s ability to develop and create new products, and support existing ones. The inevitable result will be the creation of inefficiencies, waste, uncertainty, and litigation; and reduced value of services to the public.

Ensuring that “Competitive” Products Do Not Unfairly Compete with those of Private Companies. We agree with the intention in the proposed legislation to ensure that postal products do not unfairly compete with similar products in the private sector. But we disagree with the method set out in the proposed legislation for achieving this objective. The requirement that “competitive products” as a whole contribute to institutional costs in the same proportion as “non- competitive products” is the wrong standard to use in order to ensure that postal products do not compete unfairly with

private sector products. First, the concept of “attributable” and “institutional” costs is not fully agreed upon — even by experts in the postal ratemaking industry. This uncertainty creates an unstable basis upon which to monitor whether the Postal Service is unfairly competing with the private sector. Second, given the vicissitudes of competitive markets, it is not clear that anyone could establish rates that — at year end — resulted in revenue that actually achieved the objective. Third, even if competitive products *as a whole* did meet the objective set out in H.R. 22; the Postal Service could still be unfairly competing with private industry on a particular competitive product. Thus, the financial objective set out in H.R. 22 would not achieve the goal it is designed to serve.

Competitive Products Should Only Be Required to Cover Incremental Costs and Make a Fair Contribution to Institutional Costs. In our view, so long as the Postal Service is not subsidizing competitive products, any contribution they make to the Postal Service’s otherwise fixed overhead is a benefit to society and users of the Postal Service’s “non-competitive” products. The main concern in whether USPS is unfairly competing should be whether the product is covering all incremental costs attributable to it. The Postal Service should bear the burden of demonstrating that the product will recover all such incremental costs. Once this is demonstrated, the concern that the product will unfairly compete with products offered by other companies is greatly reduced. Thus, with respect to determining what the fair contribution to overhead should be for each competitive product, the Postal Service should be provided with a reasonable degree of discretion.

Determining the “fair” contribution would not be a rigid percentage-based test, as in the proposed legislation, but would consider all relevant factors including: (1) the nature of the particular service being provided (whether it is a product traditionally offered or within the realm of products expected to be offered, by postal entities), (2) the extent to which there is a public benefit in having the Postal Service offer the service, (3) comparisons between the service being offered by USPS and private companies, (4) the extent to which competing products contribute to the overhead of the private company that offers the product, (5) the extent to which the competitive product draws upon USPS’s fixed costs, and (6) market pricing factors. Because these factors are qualitative, not quantitative, the Postal Regulatory Commission would be allowed to reverse the Postal Service’s determination of fair contribution only if it found it to be arbitrary, capricious, or clearly erroneous in light of these factors. Because customers for competitive products will “vote with their feet” the only parties who should have standing to challenge the pricing of a competitive product should be entities that offer competing products. Once a challenge is filed, however, customers should be allowed to participate in the proceeding.

The Additional Regulatory Powers Given to the Postal Rate Commission Is a Step in the Wrong Direction. We are also concerned that the revisions to the legislation provide the Postal Rate Commission — renamed the Postal *Regulatory* Commission — with too much authority over the affairs of the Postal Service. From our vantage point, there appears to be too much — not too little — regulated activity in the postal

ratemaking process. Thus, changing the name of the commission to add the word “regulation” seems to be a step in the wrong direction. In addition, the PRC would, for the first time ever, have purview over international postage rates. Aside from increasing the complexity of that ratemaking process, the intervention of the PRC in international ratemaking could negatively affect the image and influence of the Postal Service in the international postal community.

The PRC would also be given several grants of additional authority, including: conducting annual audits and reports on the speed and reliability of the mail, instructing USPS on the set up of market tests, and making many decisions concerning the separations and financing of “competitive” and “non-competitive” products. The PRC would, in essence, become another layer of postal management. Unlike other postal managers, however, the PRC would not have to deal with the consequences of the decisions it makes for the Postal Service.

Applicability of the Service Contract Act

The proposal is silent as to the applicability of the Service Contract Act (SCA), which is incorporated into the Postal Reorganization Act (39 U. S. C.) by Section 410, subsection (b)(5)(B), Application of other laws. The applicability of the SCA serves as an impediment to the Postal Service’s ability to offer price competitive services and to function as a viable competitor in the commercial marketplace. We recommend that subsection (b)(5)(B) of Section 410 be deleted from the Postal Reorganization Act.

The SCA is an impediment to making the Postal Service more efficient and competitive in that it requires a Postal Service contractor providing services, such as the transportation or delivery of mail, to pay their employees wage rates that are established by the U. S. Department of Labor.

The rates established by the Department ostensibly reflect the “prevailing” wage rates in the “locality” where the work will be performed. Actual practice demonstrates that the wage rates in fact established by the Department are frequently higher than the rates prevailing in the relevant locality. These inflated wage rates are passed on to the Postal Service in the form of higher prices for contract services, which in turn affect the rates charged to customers for these services. In addition, they can restrict otherwise fair competitive returns on Postal Service investments required to provide services.

A good example is the long-running dispute between the Department of Labor and the Postal Service over the prevailing wage rates for pilots. Pilots’ wage rates for mail hauling contracts are issued by the Department on a nationwide basis, *i. e.*, the same wage rates must be paid to pilots and other flight crew members regardless of where they are flying. Prior to 1995, the “prevailing” wage rates issued by the Department for application to the Postal Service’s ANET and WNET contracts for the air transportation of express mail were \$4,327 per month for pilots and \$3,103 per month for first officers. In 1996, the Department issued a new wage determination establishing “prevailing” rates of \$8,843

per month for pilots and \$4,967 per month for first officers, an increase of 104 percent and 60 percent, respectively.

After concerted protests by the Postal Service and a number of its contractors, the Department modified the new “prevailing” wage determinations to \$7,316 per month for pilots and \$4,314 per month for first officers. Even these modified determinations represent an increase of 69 percent for pilots and 39 percent for first officers. Such increases bear little relation to the commercial market, where wage increases have been quite modest in recent years.

The issue is not one that affects wage rates paid to employees of the Postal Service, as the SCA does not apply to their labors. The Act only applies to employees of contractors with the Government and, through the Postal Reorganization Act, to contractors with the Postal Service.

We believe that the elimination of the SCA from the Postal Reorganization Act would be consistent with the goals of that earlier act, and of the proposed Postal Reform Act of 1997.

Since its inception in 1970, the Postal Service has enjoyed significant, independent authority in procurement matters, especially as compared to Federal agencies subject to the Federal Acquisition Regulations. That broad authority is recognized in the text and legislative history of the Postal Reorganization Act itself, as well as in the case law interpreting that Act. In addition, courts have consistently recognized the uniqueness of the U. S. Postal Service in procurement matters. However, the SCA remains as a restrictive, uniquely governmental, set of procurement requirements applicable to the Postal Service.

The more permissive acquisition practices of the commercial marketplace generally result in the more streamlined and speedy procurement of equipment and services, which in turn leads to improvements in customer service. The deletion of the SCA from Postal Service contracts would represent a major step in making the Postal Service a more competitive source of services to the public.

Comments on Specific Sections

Section 405. This section creates a separate postal fund for the expenses, revenues, and obligations associated with competitive products called the “Postal Service Competitive Products Fund.” The initial funding level for the Fund is not set out. Rather, the Fund will be credited with whatever amount that the PRC determines is the net value of the assets and liabilities currently employed in providing competitive products.

Creating separate funds for “competitive” and “non-competitive” products will likely lead to more problems than it solves and will lead to uncertainty, confusion, disruption, inefficiency, and litigation. We do not see any need for the creation of separate

funds for these products. Any goal that could be attained by setting up two separate funding entities could be equally achieved through other less costly and bureaucratic means. There are certain to be disparate views concerning what assets are employed in providing competitive products and what their value should be. This provision thus creates substantial uncertainty concerning the initial funding level of the Fund, and will likely require a long and arduous PRC proceeding.

Section 405(e). This section provides that the Competitive Products Fund is to be used for payment of all attributable costs, institutional costs, and other expenses incurred in providing competitive postal products. But there is likely to be a great deal of shared costs between competitive and non-competitive products, and it may not be readily determinable how to apportion those costs between the two types of products. It is also not clear from this language whether shared costs must be paid in full from the Fund, or whether such costs can be shared with funding from non-competitive products.

Section 405(f). This section provides that a judgment against the Postal Service arising out of USPS activities in the provision of competitive products shall be paid out of the Competitive Products Fund. Once again, it is not clear from this language how a judgment related to a shared cost would be treated. More importantly, it is not fair to impose such a restriction on the enforcement of judgments obtained against the Postal Service. If an entity, such as a supplier of goods and services, obtains a judgment against the Postal Service, that entity should not be prevented from recovering on the judgment simply because the supplier was supporting a competitive product. Such a restriction would probably be unenforceable to the extent any goods were supplied to the Postal Service pursuant to a contract entered into before such legislation was enacted. But if it were enforceable, it would be egregiously unfair to the unsuspecting supplier. This restriction would provide an escape mechanism for the Postal Service to dishonor its contractual and other commitments.

Assuming the Postal Service provided notice of this restriction in its agreements, many entities doing business with the Postal Service are small businesses that do not routinely employ attorneys to review all contractual commitments. They would likely fail to note the restriction, or not appreciate its import. Instead, they would assume that the full faith and credit of the Postal Service would back any goods or services provided to the Postal Service. And those suppliers that do take note of the restriction might refuse to do business with the Postal Service or increase their prices accordingly.

Section 405(h)(2). This section provides that the Postal Service, in borrowing money, may only pledge assets of the Competitive Products Fund. Again, it is not clear what assets will be considered as part of the Fund, particularly with respect to shared assets. This uncertainty will likely limit the Postal Service's ability to borrow funds.

Section 405(j). This section provides that obligations of the Postal Service may not be purchased by Treasury or be exempt from taxation. To the extent the obligation

relates to a shared asset, this restriction is overbroad. But even if it were to relate only to the assets used only by competitive products, it creates a separate class of obligations that would require the creation of new bureaucracy within the Postal Service to manage. There is little sense in duplicating these functions within the Postal Service.

Section 405(k). This section provides that when the statute becomes effective, the Postal Service shall transfer from the Postal Service Fund to the Competitive Products Fund an amount that the PRC determines fairly reflects the net assets and liabilities that are attributed “wholly or primarily” to competitive products. Little guidance is provided to the PRC in how to make such a determination, and the PRC has not been asked previously or been equipped to make such decisions. Disagreements are inevitable, and could delay the transfer of any funds into the Competitive Products Fund. It is also unclear whether the PRC will hold hearings on such a proceeding, or whether it will allow intervenors to participate in such a hearing. If competitors are allowed to participate, they will likely press the PRC to under-value these assets.

Section 503. This section would make USPS responsible for the cost burden of congressionally mandated rate reductions for various special interests. While providing preferential mailing rates to certain groups can certainly achieve socially beneficial purposes, the cost of such programs should be born by the taxpayer, not the postal ratepayer. Providing postal rate reductions for certain groups is no different than providing entitlements, grants, tax deductions, or credits. These are benefits that should be funded by Congress, not postal patrons -- particularly when Congress has asked the Postal Service to operate in a business-like manner.

Section 604. This section sets out various restrictions on any volume discounts the Postal Service offers for competitive products (and does not permit volume discounts on non-competitive products). We generally agree with a restriction that any discounted price must not be below the attributable or incremental cost of providing the service. In certain circumstances, however, such as when a private competitor company prices its similar product below its own incremental cost of providing the service, such discounts should be permitted. Without this exception, a private company could force the Postal Service out of a particular market simply by engaging in below-cost pricing on its competing product for a short period of time. Once the Postal Service is forced out of the market, or abandons the product in market testing, the private company could then simply increase its price for the competing product.

For the reasons set out more fully in our general comments, we do not believe that volume discounts on competitive products should be subject to the requirement that such products collectively bear an equal portion of institutional costs as noncompetitive products. Once the Postal Service establishes that a competitive product is fully recovering all incremental costs, there is much less reason to fear that USPS is engaging in unfair price competition. So long as the Postal Service is recovering a fair contribution toward institutional costs, there should be no objection to volume discounts. Competitors to the Postal Service regularly engage in volume discount pricing.

Section 704. This section drops the mailbox demonstration project from the proposed legislation. We fully support this revision. Allowing non-postal entities to place materials in private mailboxes would lessen the privacy and security Americans have come to expect and rely upon in U.S. mail.